

Internal Revenue Service

memorandum

CC:TL:TS/VWATERS

TL-N-425-89

date: DEC 29 1988

to: District Counsel, Jacksonville SE:JAX
Attn: Avery Cousins, III

from: Assistant Chief Counsel
(Tax Litigation) CC:TL

subject: The Small Subchapter S Corporation Exception-Application of the
Blanco Decision

This is in response to your request for technical advice dated October 7, 1988, regarding the application of the small S corporation exception for purposes of determining the tax liability of [REDACTED].

ISSUE

Whether additional adjustments resulting from two S corporations adjustments can be assessed against the single shareholder individually on the basis that the parties entered into a consent decree in reliance that the corporations were to be considered as TEFRA entities or whether the small S corporation exception applies?

CONCLUSION

Because the shareholder is the single shareholder in both S corporations, the small S corporation exception applies for purposes of determining tax liability, and he has no liability for the subchapter S items since the TEFRA provisions do not apply.

FACTS

Taxpayer, [REDACTED], is the single shareholder in two S corporations, [REDACTED] and [REDACTED]. Additional adjustments were made to the S corporations' tax returns pursuant to the audit and litigation procedures of section 6241 through 6245. TEFRA proceedings were initiated by the shareholder in his capacity as the Tax Matters Person. In [REDACTED], the United States Tax Court entered decisions with respect to these adjustments for the taxable years ending [REDACTED] and [REDACTED]. A decision was also entered against the individual shareholder but did not include flow-through adjustments from either S corporation because they were considered to be TEFRA entities.

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The Service assessed a deficiency against the shareholder resulting from non-TEFRA adjustments to the [REDACTED] individual return on [REDACTED]. The statute of limitations has expired for issuing the shareholder a deficiency notice pursuant to I.R.C. § 6501, and the parties did not execute a Form 906 closing agreement. If the small S corporation exception does not apply, however, the statute of limitations for additional assessment under section 6229 would not expire until [REDACTED].

DISCUSSION

The Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") provides that the tax treatment of subchapter S items shall be determined at the corporate level. I.R.C. § 6241. However, with respect to single shareholder S corporations, the Tax Court has determined that the small partnership exception to the partnership audit and litigation procedures set forth in section 6231(a)(1)(B) is applicable to S corporation audits under section 6244. Blanco v. Commissioner, 89 T.C. 1169 (1987). The Blanco Court, however, left open the question of whether the exception applied to S corporations having more than one shareholder. Subsequently, the Tax Court in 111 West 16 Street Owners, Inc. v. Commissioner, 90 T.C. No. 80 (June 23, 1988), clarified this definition by holding that the statute requires only that single shareholder S corporations be excepted. This definition applies only to S corporations which tax returns are due before January 30, 1987. The regulations set the exception at five for returns due on or after that date. Temp. Treas. Reg. § 301.6241-1T(c)(2)(i).

Your question was whether the consent decisions entered into against the S corporations in reliance by the parties that the corporations were TEFRA entities would enable an assessment to be made against the shareholder even though the small Subchapter S corporation exception would normally apply. These decisions were entered subsequent to the Blanco decision. Blanco expressly provided that the S corporation audit and litigation procedures did not apply to single shareholder S corporations. In accordance with that decision, any Notice of Final S Corporation Administrative Adjustment issued to the S corporation would be invalid. Thus, the Court lacked subject matter jurisdiction under Tax Court Rule 240(c) to enter decisions against the S corporations.

Generally, when the Court lacks jurisdiction to render a decision, there are three courses of action that may be taken to serve as a remedial device. The proper remedy that should be taken is a function of the particular stage of the litigation.

First, if a sole shareholder S corporation case is filed in the Tax Court pursuant to section 6226 and a decision has not yet been rendered, a Motion to Dismiss For Lack of Jurisdiction should be prepared and forwarded to the Tax Litigation Division for review and filing with the Court. See LGM TL-47 (February 17, 1988).

Secondly, if the Court has already rendered a decision, the taxpayer is entitled to file a motion to vacate that decision. Pursuant to Tax Court Rule 162, any motion to vacate a decision must be filed within 30 days after the decision has been entered. In this case, the decisions were entered in [REDACTED]. Therefore, it is too late for the shareholder to file a motion to vacate the judgment.

Finally, if the above-noted 30 days period has lapsed, the proper remedy is for the Service to refrain from assessing any additional adjustments against the individual taxpayer. In this case, the Service should refrain from making any assessments against the taxpayer. Because the Court lacked subject matter jurisdiction under Tax Court 240(c) to enter the decisions against the S corporations, no assessment should be made against the individual taxpayer in reliance thereof.

If you have any questions, please call William Heard at FTS 566-3289 or Vada Waters at FTS 566-3233.

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